

SUBJECT: Client Advisory Committee ITEM NUMBER: 5
Meeting Briefing

ATTACHMENT(S): 2

ACTION: _____ DATE OF MEETING: April 2, 1998

INFORMATION: X PRESENTERS: Ms. DuCray-Morrill/ Mr. Hough

Congress has combined the issues of mandatory Social Security and the Social Security offset and a House Ways and Means Committee hearing to be scheduled after the Easter Congressional break in Washington, D.C. An analysis of the potential impact of mandatory Social Security to systems like STRS and its members will be presented at the hearing by a representative of the federal Governmental Accounting Office. In addition, United Teachers of Los Angeles (UTLA) has been actively leading an effort to repeal the Social Security offset provisions on behalf of California teachers. STRS staff is also working with other client groups to ensure that STRS' interests are well represented in the national debates on Social Security issues.

An opinion expressed at the CAC meeting was that the more productive strategy may be to put all energies into opposing mandatory Social Security which affects all STRS members rather than diverting energies to the offset which affects some members to varying degrees.

Adult Education

There was further discussion of the unique nature of adult education programs with the variations in how service is performed and some of the unintended results. For example, an employee may work fewer days than average in a particular month and might receive less than a full month of service credit. Alternatively, the employee may work more than the average number of days in a month. If the extra days are reported to STRS as overtime, the employee will not receive service credit for those days even if the days are not actually overtime but are part of the employee's regular workload. The employer's reporting practices thus impact the determination of service credit. Part of this problem might be resolved with reporting annualized pay rates instead of the current reporting on a monthly or hourly basis. This issue, as well as others related to adult education reporting, is currently being addressed internally and with the client and employer groups and discussions will continue at the next CAC meeting.

STRS vs. PERS

CAC participants enthusiastically approved the "STRS vs. PERS: Perceptions and Realities" document which is included as Attachment I. This paper was prepared in response to recent client newsletter articles and open discussions that cast a negative light on STRS retirement benefits when compared to PERS benefits. UTLA will feature this STRS vs. PERS comparison in their next newsletter as will the other client organizations over the next few months.

STRS versus PERS Perceptions and Realities

Concern has been expressed of late in various forums that when comparing the two statewide public employee pension systems, the Public Employees' Retirement System (PERS) and the State Teachers' Retirement System (STRS), it appears that STRS provides an inferior retirement for teachers when compared to the larger PERS system. The simple solution that has been proffered is to merge STRS into PERS and equalize the formulas by which retirement benefits are calculated. While perception of an inferior retirement package for teachers is alarming, the comparisons that have led to such conclusions must be closely scrutinized before remedies are prematurely applied.

Benefit levels in both systems are predicated upon formulas determined by the state legislature and governor; any changes in the method by which benefits are calculated require legislative action. While there are discrepancies between the benefit levels of the two systems, they are neither blatantly discriminatory nor easily remedied, as is implied by the suggestion that teachers would receive better pensions if the two systems were merged.

Comparisons of STRS and PERS usually focus on contrasting the STRS formula's retirement age factor of 2% at age 60 and above with the PERS formula which increases from 2% at age 60 to 2.418% at age 63. In this respect, the PERS formula is decidedly superior for employees who work beyond age 60. What has been omitted from the comparison is the fact

that the legislature reduced the age factor for all new state employee members of PERS beginning with hires effective 1/1/85. All new non-safety employees are placed into Tier II, the formula which provides about 50% of the level of benefits of Tier I, or a 1% at age 60 formula.

The decision to establish a Tier II with lower benefits was an act of the legislature and governor, acting beyond the authority of the PERS Board of Administration. Clearly, the Tier I formula for state employees was considered unsustainable by the legislature. Although classified school employees enjoy the higher age factor provided by Tier I, there is no guarantee that Tier I level of benefits would automatically be extended to teachers if the systems were merged, for the same reason that it is now denied new state employee members – it is economically unsustainable.

Benefit levels are determined by the legislature and governor, and must be both sustainable and self-funding. A merger of STRS and PERS would be subject to the same constraints, and any improvement in benefits would require the concurrence of the governor and legislature with a secure funding source. These are the same constraints under which STRS currently operates; merging with PERS would not relieve the state of its fiscal responsibility. A merger would simply result in shifting responsibility for STRS members' interests to the PERS administration, a large bureaucracy which is already charged to represent the interests of diverse constituencies. A change of administration would not alleviate the fiscal responsibilities nor relieve the constraint of funding improvements to STRS retirement benefits. One is hard pressed to see any improvement in the provision of services to teachers

by moving from a retirement system tailored to their needs to one of many other constituencies within the large PERS organization.

Besides the age factor formula, there are other objective and quantifiable differences between the two systems. PERS was able to build a more secure financial foundation much earlier than STRS which went on a pre-funded basis in 1972. Prior to that time, the state legislature appropriated only sufficient funding for teachers' benefits one year at a time. By 1980, STRS had assumed 40% of its annual liability, and currently attained a level of funding approaching 100%. The legislature continues to be reluctant to approve any plan that increases benefits unless a secure and sustainable source of funding is identified.

Not all differences between STRS and PERS favor PERS. A major advantage of the STRS program is its disability program which covers all vested members -- a benefit not enjoyed by PERS members. A persistent problem for all retirement programs, the erosive influence of inflation, was recently alleviated for STRS members with the passage of Senator Adam Schiff's SB 1026 which provides for 75% purchasing power protection, the same level enjoyed by PERS retirees.

Another issue that may not be widely known is that if a merger should occur between STRS and PERS teachers could be mandated into Social Security since PERS is generally coordinated with Social Security for most of the members. This would increase employee and employer contributions by 6.2% of salary each for a total contribution of 12.4%, in effect eliminating the ability to fund increases in STRS benefits. Increasing STRS benefits to a level

commensurate with PERS benefits would not cost 12.4% and would not be subject to the influence of Congress and the Federal Administration. Working with STRS, the Legislature and Governor to increase STRS benefits would be preferable to merging with PERS with the same benefits as STRS currently provides with Social Security.

An important disparity between the two systems is the 2% cost-of-living adjustment (COLA) for benefit recipients. STRS provides a 2% non-compounded COLA where PERS pays a 2% compounded COLA. While the compounded COLA is undeniably an improved benefit over STRS' simple COLA, it only delays eligibility for purchasing power benefits for one year. For example, applying the current assumption for inflation, a retiree would be eligible for 75% purchasing at the same rate after retirement as if non-compounded COLA's are paid. Compounding the COLA does delay the erosion of purchasing power to 75%, yet the cost for compounding the COLA is reaching \$175 million a year.

STRS has closed the funding gap in far less time than originally projected, an accomplishment that should be touted to the legislature and governor and offered as evidence that the time has come to consider an increase in STRS benefits. No one denies that the retirement benefits of California teachers need improvement. However, the current benefit structure is rooted in concrete funding liabilities which will not disappear with a change of name or merger with the PERS system. Rather, STRS members, working collectively through their unions and professional organizations, need to offer well-considered options to persuade the legislature and governor of the need to make improvements to the present system. PERS is no panacea for the challenges before us. We must instead do the difficult work of improving upon the

present system, dealing with the real problems rather than expending our time and energies on the pursuit of an illusory quick fix to the reality of limited resources.

STRS has struggled since 1972 to amortize and pay off the debt incurred by failing to fully fund benefits from its inception in 1913. Significant progress has been made in the last ten years and as STRS approaches full-funding status, benefit increases may be attainable. Funding for these benefit increases must be clearly identified, and research-based options identified and pursued through the legislative process.

COMPARISON
STRS - PERS State Employees - PERS Classified School Employees
(Tier I) - Non-Safety

| | STRS | PERS: Classified School Member | PERS: State Miscellaneous (Non-safety) (Tier I) |
|-----------------------------------|---|---|--|
| Eligibility for Membership | <ul style="list-style-type: none"> - All certificated and faculty employees in public schools (K-14) whose basis of employment is 50% or more (mandatory membership) - Part-time and substitute certificated and faculty employees hired to work less than one-half time may elect to be a member | <ul style="list-style-type: none"> - Non-teaching, noncertificated school employees working one-half time or more - Part-time non-teaching employees working less than one-half time may <u>not</u> be a member | <ul style="list-style-type: none"> - Non-safety state employees working one-half time or more - Non-elected legislative employer - Employees working less than one-half time may <u>not</u> be a member |
| Normal Retirement Age | 60 | 60 | 60 |
| Vesting Requirement for: | | | |
| - Service Retirement | 5.000 years credited service Note: 30.000 years service credit required for retirement between ages 50-55 | 5.000 years credited service | 5.000 years credited service |
| - Disability Retirement Allowance | 5.000 years credited service or 1.000 year credited service for disability resulting from a violent act perpetrated during the course of one's employment | 5.000 years credited service or 1.000 year credited service for disability resulting from a violent act perpetrated during the course of one's employment | 5.000 years credited service |

| STRS | | PERS: Classified School Member | PERS: State Miscellaneous (Non-safety) (Tier I) |
|---|--|--|--|
| - Survivor Benefits | 1.000 year service credit | Benefits are payable based on whether or not the member was eligible for retirement at the time of death, e.g. at least age 50 with 5.000 years of service credit | |
| - Death Payment (Lump Sum) | 1.000 year service credit | The death benefit amount is graduated, with the full amount payable after six years of service credit. | |
| Benefit Formula at Normal Retirement Age (Age 60) (Service Retirement) | 2% @ 60 (2 \times years of credited service \times final compensation) | 2% @ 60 (2 \times years of credited service \times final compensation) | 2% @ 60 (2 \times years of credited service \times final compensation) |
| Age Formula (Factor) After Age 60 (Service Retirement) | Same as at age 60 - 2% | 2.134 @ age 61 2.272 @ age 62 2.418 @ age 63 | 2.134 @ age 61 2.272 @ age 62 2.418 @ age 63 |
| Benefit Formula Prior to Age 60 (Normal Retirement Age): (Service Retirement) | 1.88 @ age 59 1.76 @ age 58 1.64 @ age 57 1.52 @ age 56 1.40 @ age 55 1.34 @ age 54 1.28 @ age 53 1.22 @ age 52 1.16 @ age 51 1.10 @ age 50 | 1.874 @ age 59 1.758 @ age 58 1.650 @ age 57 1.552 @ age 56 1.460 @ age 55 1.376 @ age 54 1.296 @ age 53 1.224 @ age 52 1.156 @ age 51 1.092 @ age 50 | 1.874 @ age 59 1.758 @ age 58 1.650 @ age 57 1.552 @ age 56 1.460 @ age 55 1.376 @ age 54 1.296 @ age 53 1.224 @ age 52 1.156 @ age 51 1.092 @ age 50 |
| Rule of 85 | No | No | No |
| Final Compensation | Highest average compensation for 36 consecutive months Note: Districts can choose to provide final compensation averaged over 12 consecutive months | Highest average compensation for 36 consecutive months <u>No</u> option to choose compensation averaged for 12 consecutive months | Highest average compensation for 12 consecutive months |

| STRS | | PERS: Classified School Member | PERS: State Miscellaneous (Non-safety) (Tier I) |
|---|---|--|--|
| Disability Formula | 50% of final compensation (some exceptions in Coverage A) | 1.8% x years of credited service x final compensation Benefit may be improved to 33-1/3% for service credit between 10 & 18-1/2 years | 1.8% x years of credited service x final compensation Benefit may be improved to 33-1/3% for service credit between 10 and 18-1/2 years |
| Automatic Cost-of-Living Adjustment | 2% annual <u>simple</u> | 2% annual <u>compounded</u> | 2% annual <u>compounded</u> |
| Purchasing Power Adjustment | 75% | 75% | 75% |
| Credit for Unused Sick Leave | Yes - for persons who weremem- bers prior to 7/1/80 | Yes - for persons who weremem- bers prior to 7/1/80 | Yes - for all members regardless of date of hire |
| Golden Handshake: 2 Years additional Service Credit | Yes | Yes | Yes |
| Health Benefits After Retirement | Provided only on a district-by- district basis. Districts may choose to provide PEMHCA coverage | Provided only on a district-by- district basis. Districts may choose to provide PEMHCA coverage | Yes (If a member retires either 120 days of separation of employment with the requisite 5, 10 or 20 year vesting requirement) |
| Purchase of Ser- vice Credit | | | |
| - Out-of-State Ser- vice | Yes, Effective 1-1-99 for public school employment | No | No |
| - Military | Yes | Yes | Yes |
| - Redeposit of With- drawn Contributions | Yes | Yes | Yes |

| | STRS | PERS: Classified School Member | PERS: State Miscellaneous (Non-safety) (Tier I) |
|--|-------------|---|---|
| <hr/> | | | |
| Miscellaneous Issues | | | |
| - Ability to Adjust Employer Contribution Rate | No | Yes | Yes |
| - Current Contribution Rates | | | |
| - Employee | 8% | 7% in Social Security: 7% of salary over \$133.33 No Social Security: 7% of salary | In Social Security, 5% of salary over \$513. No Social Security, 6% of salary over \$317. |
| - Employer | 8.25% | 6.172% (as of FY 1997/98) | Varies based on actuarial calculations (12.721% as of FY 1997/98) |

COMPARISON OF STRS/PERS OPTION FACTORS
Beneficiary Assumed To Be Age 55 In All Cases

| | Option 2 | | Option 3 | | Option 6 | | Option 7 | |
|------------|----------|---|----------|---|----------|---|----------|---|
| Member Age | STRS | PERS School Classified & State Tier I | STRS | PERS School Classified & State Tier I | STRS | PERS School Classified & State Tier I | STRS | PERS School Classified & State Tier I |
| 55 | 89.2 | 89.2 | 95.4 | 94.3 | 88.4 | 87.9 | 95.0 | 93.6 |
| 56 | 88.3 | 88.4 | 95.0 | 93.8 | 87.5 | 87.1 | 94.5 | 93.1 |
| 57 | 87.3 | 87.5 | 94.5 | 93.3 | 86.5 | 86.1 | 94.0 | 92.6 |
| 58 | 86.3 | 86.6 | 94.0 | 92.8 | 85.4 | 85.2 | 93.5 | 92.0 |
| 59 | 85.2 | 85.6 | 93.5 | 92.2 | 84.3 | 84.1 | 92.9 | 91.4 |
| 60 | 84.0 | 84.5 | 92.9 | 91.6 | 83.0 | 83.1 | 92.3 | 90.7 |
| 61 | 82.7 | 83.4 | 92.2 | 90.9 | 81.8 | 81.9 | 91.7 | 90.1 |
| 62 | 81.4 | 82.2 | 91.5 | 90.2 | 80.4 | 80.7 | 90.9 | 89.3 |
| 63 | 79.9 | 81.0 | 90.8 | 89.5 | 78.9 | 79.4 | 90.2 | 88.5 |
| 64 | 78.4 | 79.6 | 90.0 | 88.7 | 77.4 | 78.1 | 89.3 | 87.7 |
| 65 | 76.8 | 78.2 | 89.1 | 87.2 | 75.8 | 76.6 | 88.5 | 86.8 |
| 66 | 75.1 | 76.7 | 88.2 | 86.8 | 74.1 | 75.1 | 87.5 | 85.8 |
| 67 | 73.3 | 75.1 | 87.2 | 85.8 | 72.3 | 73.5 | 86.5 | 84.8 |
| 68 | 71.4 | 73.4 | 86.1 | 84.7 | 70.5 | 71.9 | 85.4 | 83.6 |
| 69 | 69.5 | 71.7 | 85.0 | 83.5 | 68.5 | 70.2 | 84.3 | 82.5 |
| 70 | 67.5 | 69.9 | 83.8 | 82.3 | 66.5 | 68.4 | 83.1 | 81.2 |